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Chairman Nussle, Congressman Spratt, and Members of the Committee, thank you for inviting me to testify today on structural reform of the federal budget process. Next year, the major provisions of the Budget Enforcement Act of 1990 (BEA) will expire. That law has provided the basic enforcement framework for lawmakers' budgetary deliberations for the past decade. As lawmakers consider whether or how it should be extended, they could also consider other changes in the budget process and in fundamental budget concepts that would address broader concerns that have surfaced over the years.

My testimony today will make the following major points:

- Despite recent difficulties, the BEA framework of discretionary spending limits and pay-as-you-go (PAYGO) enforcement has generally promoted budget discipline. Also, broader changes in the budget process, such as certain changes proposed in the Nussle-Cardin budget reform legislation of the 106th Congress (H.R. 853), could help to improve that process.

- It is time to reevaluate the broad budget concepts on which the federal budget process is based. Budget concepts were last reviewed comprehensively in 1967, by the President's Commission on Budget Concepts. During the intervening years, changes in the federal budget and in modern legislative proposals affecting the budget have raised significant issues about appropriate budgetary treatment that are not covered by the commission's recommendations. This suggests that a new budget concepts commission, or some other forum for reaching a consensus on those issues, may be needed.

## EXTENDING THE BEA AND OTHER BUDGET PROCESS CHANGES

Lawmakers enacted the Budget Enforcement Act as part of a multiyear agreement to reduce deficits. That law amended the Balanced Budget and Emergency Deficit Control Act of 1985, replacing its regimen of fixed deficit targets with a new system of procedures for controlling deficits. The BEA established statutory limits on discretionary spending and a PAYGO requirement for new mandatory spending and revenue laws. In general, the BEA disciplines—now scheduled to expire at the end of fiscal year 2002—were intended to ensure that new spending and revenue laws did not increase

projected deficits. The discretionary caps and PAYGO requirement (like the deficit targets before them) are enforced by sequestration, a process that imposes automatic, generally across-the-board cuts in spending if those disciplines are not met.

As the Congressional Budget Office (CBO) testified before the committee last month, the BEA framework has provided a solid foundation for budget discipline for most of the past decade. From 1991 through 1997, the law's limits on discretionary appropriations and its PAYGO requirement helped to control deficits. The growth of total discretionary outlays was held well below the overall rate of inflation. (Within that total, however, growing appropriations for many nondefense discretionary accounts were offset by a steep decline in defense spending in the aftermath of the Cold War.) New mandatory spending and revenue laws enacted during the period did not increase net deficits.

With the emergence in 1998 of large and growing surpluses, however, the fiscal environment changed. Yet the BEA framework, which had been recently extended through 2002 by the 1997 Balanced Budget Act, remained in effect. Surpluses put increasing pressure on lawmakers to circumvent the discretionary spending caps and the PAYGO requirement, making those disciplines much less effective.

In 1999 and 2000, lawmakers enacted record levels of emergency appropriations—which are effectively exempt from budget enforcement procedures—and used other funding devices to boost discretionary spending well above the caps set in 1997. Although lawmakers set higher caps for 2001, CBO's baseline estimates of total discretionary spending for 2002 exceed the adjusted caps, which lawmakers have not yet reset, by more than $100 billion (for both budget authority and outlays).

Despite recent experience, the underlying philosophy of the Budget Enforcement Act—that appropriations should be enacted within enforceable limits, and the estimated costs of new mandatory spending and tax legislation should generally be offset—has proven to be effective. It could continue to be an important component of overall budget discipline. Even in a period of surpluses, maintaining an effective framework of budget discipline is an important hedge against uncertain budget projections and political pressure to increase spending.

As lawmakers consider extending the BEA, they may also want to make changes to improve its framework. For example, they may want to add specific criteria in law that would set out the purposes for which the emergency spending designation should be used. In 1991, as part of a mandated report on the costs of certain emergencies in that year, the Office of Management and Budget identified several criteria used in the executive branch for deciding the type of provisions that would qualify for emergency appropriations.[1] The criteria specify that the emergency designation

[1]Office of Management and Budget, *Report on the Costs of Domestic and International Emergencies and on the Threats Posed by the Kuwaiti Oil Fires as required by P.L. 102-55* (June 1991).

should be used only for spending that is necessary, sudden, urgent, unforeseen, and temporary. They were never codified, and in the past few years lawmakers have chosen to disregard them. Formal guidelines—codified into law—would help to inform the debate over emergency spending and to minimize abuses of the emergency spending designation.

Lawmakers may also wish to adapt the BEA framework to an environment of surpluses. Many lawmakers have expressed their commitment to preserving off-budget surpluses for debt reduction. The BEA framework could be modified to enable lawmakers to enact legislation that would use some portion of the projected on-budget (non-Social Security) surpluses for new spending or revenue policies, while protecting the off-budget surpluses using the BEA's sequestration process.

Because the context for the coming debate about extending the BEA is likely to differ considerably from the context in earlier years, it may also prompt a wider look at the budget process. Indeed, last year, the House considered legislation that would have changed the process in ways that could help to improve budgetary decisionmaking. That legislation (H.R. 853) was developed by the Task Force on Budget Process (the Nussle-Cardin task force) of the House Budget and Rules Committees.

For example, a number of lawmakers worry that the budget process is too complex and confusing; they would like to make it simpler, easier to understand, and more efficient. They contend that excessive complexity in the budget process, among other factors, has led to delays in enacting budget legislation—especially appropriation laws. They favor converting the annual budget cycle to a two-year timetable, providing for automatic continuing appropriations, and turning the Congressional budget resolution into a joint resolution signed by the President (proposals that were considered during the debate on H.R. 853). Although those proposals may help to ease delays and reduce complexity, no procedural changes can guarantee agreement on budget policies.

## REVIEWING FEDERAL BUDGET CONCEPTS

In addition to extending the BEA enforcement mechanisms and considering other changes to the budget process, lawmakers should, as part of any structural reform, revisit the framework of fundamental budget concepts and accounting principles that underlies their annual deliberations over the federal budget.

The basic accounting rules generally followed in the modern budget process are set forth in the 1967 *Report of the President's Commission on Budget Concepts*.[2] Although the report has no legal status, it remains to this day the most authoritative statement on federal budgetary accounting concepts and principles. The commission's most important recommendation was for a comprehensive federal budget. It recommended that the budget cover the full range of federal

[2]President's Commission on Budget Concepts, *Report of the President's Commission on Budget Concepts* (October 1967).

activities and that even borderline activities and transactions be covered unless there were compelling reasons to exclude them.

Although the commission's guidelines continue to apply broadly to the budget process, they do not accommodate many of today's complex budget proposals and institutions. Lawmakers and budget scorekeepers now face fundamental questions:

- What is the appropriate scope of the budget? The commission's recommendation that the budget should include all federal activities provides little or no guidance on how to treat various public/private partnerships such as Amtrak and similar hybrid entities.

- When should a program be classified as spending rather than an offset to taxes? The line dividing federal spending and revenue law has become blurred, as shown by the increasing use of so-called refundable tax credits and certain fees as devices for expanding budgetary resources for spending programs.

- Does the use of trust funds for tracking earmarked revenue confuse lawmakers and the public? The proliferation of federal trust funds, which now exceed 200, raises important questions about the extent to which those and other earmarking devices in the federal budget may distort the overall budgetary choices that lawmakers face each year.

- How do we accurately measure the federal government's effect on the economy? The purchase and sale of nonfederal debt and equities, important components of some proposals to reform Social Security, raise thorny issues of budgetary treatment that are important for estimating the costs associated with those proposals.

Those questions are examined in more detail below.

**Budget Coverage**

As the 1967 Commission recommended, the federal budget should encompass the full scope of federal programs and entities. It suggested certain broad criteria to help make such determinations. For example, who owns an entity and selects the managers? Do the Congress and the President have control over an entity's program and budget, or are its policies set primarily in response to private owners and not to accomplish some broader public purpose?

Despite the broad scope of the commission's guidelines, they do not clarify the appropriate budgetary treatment of certain partnerships between the federal government and the private sector that appear to be largely federally-controlled. For example, the business operations of Amtrak are generally excluded from the federal budget, but Amtrak's board members are appointed by the President, its preferred stock is owned by the Department of Transportation, and the federal

government controls the routes that Amtrak uses. In addition, Amtrak has not earned any profit in its more than 20 years of existence. Our economic system would not permit any truly private entity to continue under those conditions. Other examples of hybrid, public/private entities include the Metropolitan Washington Airports Authority and agricultural marketing boards.

If lawmakers determine that the budget should continue excluding such entities, then perhaps a new or more complete list of criteria should be developed to better distinguish between federal and nonfederal entities for budgetary purposes.

**The Line Between Spending and Revenues**

Over the past 30-plus years, the division between taxes and spending has become muddled. Maintaining a consistent and clear distinction in the budget between spending and taxes would give lawmakers and the public a more accurate picture of the size of the federal government and the amount of budgetary resources it committed.

For example, the tax code has been changed extensively in recent years to grant taxpayers credits against their tax liability for a diverse array of public policy goals. Those tax credits generally are classified as affecting receipts, but in many cases they establish benefits that may be completely unrelated to the amount of taxes otherwise due or that exceed a taxpayer's liability. Known as refundable credits, tax credits that exceed a taxpayer's liability appear to resemble spending for public policy purposes rather than receipts.

Tax credits now exist for such diverse activities as the production of alternative fuels, reforestation, education, and income support. The generous use of tax credits understates the true size of the government and distorts information about federal spending priorities. Also, the Congress may be more willing to create a new tax credit than a new spending program.

In addition, the distinction between revenues and offsetting collections, which are treated as offsets to spending, is also a concern. Offsetting collections from the public typically are linked to a business-type activity or service provided to the public by a federal agency. In the budget process, they are distinguished from revenues collected under the federal government's sovereign power to tax or regulate. Over the years, laws have been enacted that classify certain revenues as offsetting collections. However, revenues that are improperly classified as an offset to spending provide a distorted picture of government finances.

A prominent example is fees collected by the Securities and Exchange Commission (SEC). Normally, those fees would be classified as revenues, not as offsetting collections, in part because they are not associated with a business-type transaction but rather collected, as are other taxes, under the government's sovereign powers. However, laws have been enacted requiring some of those fees to be counted as offsetting collections credited to the appropriation account for SEC salaries and expenses, while some existing SEC fees are recorded as governmental receipts (that is, revenues).

Without such laws directing the budgetary accounting, all SEC fees would be counted as general revenues.

**Trust Funds**

The federal government accounts for its activities through two broad groups of funds: federal funds and trust funds. In general, trust funds are created in law to earmark receipts for specific programs and purposes. The General Accounting Office has identified over 200 trust funds in the federal budget, although fewer than a dozen account for the vast majority of trust fund receipts and spending.[3]

Federal trust funds differ significantly from private-sector trust funds. For example, claims against private trust funds are limited by the value of the fund's assets. By contrast, federal trust funds function as accounting mechanisms that record tax receipts, user fees, and other credits and associated expenditures. When trust fund receipts exceed expenditures, the government's books show trust fund balances. However, those balances are claims on the Treasury that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures. The existence of large trust fund balances, therefore, does not by itself have any impact on the government's ability to pay benefits.

Further, the beneficiary of a private trust fund usually owns the fund's income and often owns its assets. The trustees of the fund also have a fiduciary responsibility to manage the fund on behalf of its beneficiaries and cannot make unilateral changes to the provisions governing the trust. In contrast, federal trust funds generally are owned by the federal government. They are created in law, and lawmakers can change those laws or repeal them.

Those and other distinctions between federal and private trust funds create confusion among lawmakers and the public and cause some people to argue that the spending and revenues credited to federal trust funds should be treated differently in the budget process. That puts pressure on lawmakers to favor those trust funds in their annual budgetary deliberations and potentially limits their flexibility in setting broad budget policies and priorities for the budget generally.

**Budgetary Treatment of Private Equities**

Government purchases of private securities, including corporate bonds and equities, pose an interesting and unprecedented dilemma for the federal budget. Such purchases are a part of certain major proposals to reform Social Security.

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[3]General Accounting Office, *Federal Trust and Other Earmarked Funds: Answers to Frequently Asked Questions,* GAO-01-199SP (January 2001). The report is also available at www.gao.gov.

Under current budgetary guidelines, purchases of private financial securities are recorded as cash outlays; the sales of the securities and returns such as dividends and interest payments are recorded as offsetting receipts. The budgetary treatment is the same for investments in private financial securities as it is for investments in nonfinancial assets.

On the one hand, important distinctions exist between financial and nonfinancial assets. In general, financial assets are acquired to generate a flow of income rather than to provide public services such as national security, health care, or recreation. This suggests that government purchases of private equities should be treated differently in the budget than purchases of nonfinancial assets. On the other hand, if equity purchases were not counted as outlays, the budget would not accurately reflect the level of the federal government's ownership and control of the private sector. That would seem to violate one of the fundamental principles of the 1967 Commission—that the budget should reflect the true extent of the government's interactions with the economy.

## CONCLUSIONS

On balance, the BEA framework has improved budget discipline. Extending that framework, under the right circumstances, would contribute to continued budget discipline. As lawmakers consider extending the BEA, they may wish to add criteria for the emergency spending designation and make changes that would adapt the BEA to a period of surpluses. Other changes in the budget process, such as some of those recommended in the Nussle-Cardin bill, may help to address lawmakers' broader concerns about the budget process.

As important as those concerns, however, is the issue of the status of the fundamental budget concepts that underlie the federal budget process. Those concepts have not been comprehensively reviewed since the President's 1967 Commission on Budget Concepts. The 1967 guidelines leave unanswered a number of thorny questions about the budgetary treatment of modern budgetary legislation.

The answers to those questions have significant implications for certain major budget policy proposals, including Social Security reform, and how those proposals should be accounted for in the federal budget. Consequently, they should not be left to budget technicians and scorekeepers to resolve. One approach would be to create a new budget concepts commission that could sort through the various options and make appropriate recommendations, much as the President's Commission did over 30 years ago. Such an approach would help lawmakers to review conceptual issues comprehensively and may help to promote a consensus on how those issues should be resolved.